

DEPARTMENT OF HAWAIIAN HOME LANDS
STATE OF HAWAII

FINANCIAL STATEMENTS
WITH ACCOMPANYING INFORMATION
FOR THE YEAR ENDED JUNE 30, 2004

AND

INDEPENDENT AUDITORS' REPORT

Akamine, Oyadomari & Kosaki

CERTIFIED PUBLIC ACCOUNTANTS, INC.

November 5, 2004

Mr. Micah Kane, Chairman
Hawaiian Homes Commission
Department of Hawaiian Home Lands
State of Hawaii

Dear Mr. Kane:

This is our report on the audit of the financial statements of the Department of Hawaiian Home Lands, State of Hawaii, for the year ended June 30, 2004. Our audit was performed in accordance with the terms of our contract with the Department.

OBJECTIVES OF THE AUDIT

The primary purpose of our audit was to form an opinion on the fairness of the presentation of the Department of Hawaiian Home Lands, State of Hawaii's, financial statements for the year ended June 30, 2004.

More specifically, the objectives of the audit were as follows:

1. To provide a basis for an opinion on the fairness of the presentation of the Department of Hawaiian Home Lands, State of Hawaii's, financial statements.
2. To determine whether expenditures have been made and all revenues and other receipts to which the Department of Hawaiian Home Lands, State of Hawaii, is entitled have been collected and accounted for in accordance with the laws, rules and regulations, and policies and procedures of the State of Hawaii.
3. To evaluate the adequacy of the Department of Hawaiian Home Lands, State of Hawaii's, internal control over financial reporting to determine whether there is effective control over and proper accounting of revenues, expenditures, disbursements, assets and liabilities and to comply with the applicable laws and regulations.

SCOPE OF THE AUDIT

Our audit was performed in accordance with auditing standards generally accepted in the United States of America, as prescribed by the American Institute of Certified Public Accountants, and Government Auditing Standards, issued by the Comptroller General of the United States, as they pertain to financial audits. The scope of our audit included a general audit of the financial transactions and accounting records of the Department of Hawaiian Home Lands, State of Hawaii, for the year ended June 30, 2004. In addition, as part of our determination as to whether the Department of Hawaiian Home Lands, State of Hawaii, has effective controls over and proper accounting of revenues, receipts, expenditures, disbursements, assets and liabilities we considered the internal control over financial reporting.

We wish to express our appreciation for the excellent cooperation and assistance extended by the officers and staff of the Department of Hawaiian Home Lands, State of Hawaii.

Sincerely,

Akamune, Oyadomari : Kosaki CPAs, Inc.

DEPARTMENT OF HAWAIIAN HOME LANDS
STATE OF HAWAII

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DEPARTMENT OF HAWAIIAN HOME LANDS
STATE OF HAWAII

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PART I
FINANCIAL SECTION

FINANCIAL STATEMENTS

Akamine, Oyadomari & Kosaki

CERTIFIED PUBLIC ACCOUNTANTS, INC.

Independent Auditors' Report

Chairman
Hawaiian Home Lands Commission
State of Hawaii

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Department of Hawaiian Home Lands, State of Hawaii, as of and for the year ended June 30, 2004, which collectively comprise the Department's basic financial statements, as listed in the foregoing table of contents. These financial statements are the responsibility of the management of the Department of Hawaiian Home Lands, State of Hawaii. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

As discussed in Note A to the financial statements, the financial statements of the Department of Hawaiian Home Lands, State of Hawaii, are intended to present the financial position, and the changes in financial position, of only that portion of the governmental activities, each major fund, and the aggregate remaining fund information of the State that is attributable to the transactions of the Department. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2004, and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund and the aggregate remaining fund information of the Department of Hawaiian Home Lands, State of Hawaii, as of June 30, 2004, and the respective changes in financial position thereof for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

We also audited the adjustments described in Note I to the financial statements that were applied to restate the financial statements. In our opinion, such adjustments are appropriate and have been properly applied.

The Management's Discussion and Analysis on pages 9 through 19 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Department of Hawaiian Home Lands, State of Hawaii's, basic financial statements. The information on the Combining Balance Sheet - Nonmajor Governmental Funds and Combining Statement of Revenues, Expenditures and Changes in Fund Balances - Nonmajor Governmental Funds, are presented for purposes of additional analysis and is not a required part of the basic financial statements. The Combining Balance Sheet - Nonmajor Governmental Funds and Combining Statement of Revenues, Expenditures and Changes in Fund Balances - Nonmajor Governmental Funds, have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

In accordance with Government Auditing Standards, we have also issued our report dated October 5, 2004 on our consideration of the Department of Hawaiian Home Lands, State of Hawaii's, internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

Akamune, Oyadomari & Kosaki CPAs, Inc.

Honolulu, Hawaii
October 5, 2004



STATE OF HAWAII
DEPARTMENT OF HAWAIIAN HOME LANDS

P.O. BOX 1879
HONOLULU, HAWAII 96805

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following Management's Discussion and Analysis (MD&A) is designed to provide an overview of the financial performance of the Department of Hawaiian Home Lands (Department) for the fiscal year ended June 30, 2004. Please read it in conjunction with the transmittal letter at the front of this report and the Department's financial statements, which follow this section.

FINANCIAL HIGHLIGHTS FOR FISCAL YEAR 2004

- The Department's total net assets, the amount of assets exceeding liabilities, totaled \$513.2 million. Of this amount, \$266.6 million is unrestricted and \$246.6 million is invested in capital assets, net of related debt.
- The Department's total net assets increased \$27.4 million over the course of this year's operation.
- In fiscal year 2004, the Department's expenditures exceeded revenues by \$2.6 million. In fiscal year 2003, expenditures exceeded revenues by \$4.9 million.
- The total expenditures of the Department increased by \$3.9 million, or 17.3%.
- The General Fund appropriation was \$47,596 less than fiscal year 2003. This represents a 3.5% decrease in General Fund appropriations.
- The total fund balance of the Department's governmental funds increased by \$23.1 million, which was largely due to the Department's \$30 million annual settlement payment from the State of Hawaii.

OVERVIEW OF THE FINANCIAL STATEMENTS

This MD&A serves as an introduction to the Department's basic financial statements. The basic financial statements are comprised of three components: (1) department-wide financial statements, (2) fund financial statements, and (3) notes to the financial statements. This report

also contains other supplementary information (combining financial statements – nonmajor governmental funds) in addition to the basic financial statements.

The first two statements are *department-wide financial statements* that provide both long-term and short-term information about the Department's overall financial status and operations.

The *fund financial statements* focus on individual parts of the Department, reporting the Department's status and operations in more detail than the department-wide financial statements. These statements tell how general departmental services were financed in the short term as well as what remains for future spending.

The statements are followed by a section of required supplementary information that further explains and supports the information in the fund financial statements. The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data.

Department-wide Financial Statements

The department-wide financial statements provide a broad view of the Department's operations. The statements provide both short-term and long-term information about the Department's financial position and activities, which assists in assessing the Department's economic condition at the end of the fiscal year and operations for the year then ended. These statements are prepared using the flow of economic resources measurement focus and the accrual basis of accounting. The department-wide financial statements include two statements:

The statement of net assets presents all of the Department's assets and liabilities. The difference between the assets and liabilities are reported as "net assets".

The statement of activities presents information showing how the Department's net assets changed during the fiscal year. This statement presents a comparison between direct expenses and program revenues for each division of the Department.

The activities of the Department are mostly supported by State Appropriation, rental income from commercial land leases and intergovernmental revenues. The Department's basic services fall under this type of activity.

Fund Financial Statements

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Department uses fund accounting to ensure and demonstrate compliance with legal requirements.

The fund financial statements provide more detailed information about the Department's status and operations. Certain of the Department's funds were established under State Law or by bond covenants. Other funds of the Department are established by the Hawaiian Homes Commission. These funds manage money for particular purposes.

The Department only has Governmental Funds which finance the Department's basic services. Governmental funds are used to account for essentially the same functions reported as governmental activities in the department-wide financial statements. However, unlike the department-wide financial statements, the fund financial statements focus on near-term inflows and outflows of spendable resources as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating the Department's short-term financing requirements.

Because the focus of fund financial statements is narrower than that of the department-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the department-wide financial statements. By doing so, readers may better understand the long-term impact of the department's short-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The Department has fourteen governmental funds, eight of which are considered major funds for presentation purposes. Each major fund is presented in a separate column in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures and changes in fund balance. These funds are briefly described as follows:

General Fund – The general fund is authorized and appropriated by the State Legislature each year for planning, development, management and general support for Hawaiian Homestead Program.

Hawaiian Home General Loan Fund – This revolving loan fund was established from a consolidation of all loan funds other than the Hawaiian Home loan fund in 1986. The major source of receipts for this fund is through principal repayment. The department can make loans from the revolving funds for repair, maintenance, purchase or erection of dwellings on any tract and any permanent improvements; purchase of livestock and farm equipment; assistance in developing land; farm loans not to exceed \$50,000; and commercial loans.

Hawaiian Home Lands Trust Fund – This fund was established by Act 14, Special Session 1995 which settles all claims made on behalf of the Hawaiian Home Lands Trust against the State between August 21, 1959 and July, 1988. It requires that the State make twenty annual deposits of \$30,000,000 or their discounted equivalent into the Hawaiian Home Lands Trust Fund. Proceeds of the fund may be used by the department for capital improvements and to meet the requirements of the Hawaiian Homes Commission Act of 1920, as amended.

Hawaiian Home Operating Fund – This fund was established through a merger of Hawaiian Home Development fund and Hawaiian Home Operating fund in 1986. Any interest or earnings arising out of investments from the Hawaiian Home Loan Fund are to be credited to and deposited into the Hawaiian Home Operating Fund. All monies received by the department from any other source, other than those prescribed in other funds of the Hawaiian Homes Commission Act, are deposited into this fund. The department uses the fund for construction operation and maintenance of revenue-producing activities that are intended to serve principally occupants on Hawaiian home lands, and also uses the fund to make the improvement and development necessary to serve present and future occupants of Hawaiian home lands.

Hawaiian Home Receipts Fund – All interest monies from loans or investments received by the department from any fund, except the Hawaiian Home Loan Fund, Hawaiian Home Administration Account, Native Hawaiian Rehabilitation Fund, Hawaiian Home Lands Revenue Bond Special Fund and Hawaiian Home Trust Fund, are deposited into this fund. This fund serves as a clearing account at the end of each quarter, all monies in this fund are transferred to other funds as required by the Hawaiian Homes Commission Act.

Hawaiian Home Administration Account – The revenue sources of this fund are the entire receipts from any leasing or other dispositions of “available lands” and any interest or other earnings arising out of investments from this fund. The department expends the monies for salaries and all other administrative expenses of the department, excluding capital improvements, in the absence of general funds appropriated for operating and administrative costs.

Federal Grants – The Department is the recipient of annual block grants under the Native American Housing and Self-Determination Act (NAHASDA). Each fiscal year, HUD will make a grant under the Act to the Department to carry out affordable housing activities for Native Hawaiian families who are eligible to reside on the Hawaiian Home Lands.

Temporary Deposits – This fund accounts for refundable deposits to lessees of Hawaiian Home Lands.

The accompanying Notes to the Financial Statements are part of the financial statement. The notes provide additional information that is essential to gain a full understanding of the data provided in the department-wide and fund financial statements.

In addition to the basic financial statements and accompanying notes this report also presents other supplementary information consisting of the Combining Balance Sheet and Combining Statement of Revenues, Expenditures and Changes in Fund Balance in connection with non-major governmental funds and Schedule of Expenditures of Federal Awards.

FINANCIAL ANALYSIS OF THE DEPARTMENT AS A WHOLE

Net Assets

The 2003 capital assets and investment in capital assets, net of related debt, were restated to eliminate \$26.2 million of infrastructure costs which were sold or reimbursed and reverse \$2.8 million of accumulated depreciation related to these costs. After the restatements, the Department’s total net assets were increased \$27.4 million to approximately \$513.2 million between fiscal year 2003 and 2004. A large portion of the Department’s net assets (50%) reflects its investment in capital assets such as land, buildings, infrastructure and construction-in-progress. The Department uses these capital assets to provide public lands which are leased to native Hawaiians, consequently, these assets are not available for future spending. Although the Department’s investment in its capital assets are reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets cannot be used to liquidate these liabilities.

The following is a comparative statement of net assets:

Summary of Statement of Net Assets
(in millions)

	2004	2003 (as restated)	Increase (Decrease)
Current and Other Assets	\$ 277.9	\$ 253.2	\$ 24.7
Capital Assets	259.0	251.6	7.4
Total Assets	<u>\$ 536.9</u>	<u>\$ 504.8</u>	<u>\$ 32.1</u>
Long-term Debt Outstanding	\$ 11.8	\$ 12.4	\$ (0.6)
Other Liabilities	11.9	9.4	2.5
Total Liabilities	<u>\$ 23.7</u>	<u>\$ 21.8</u>	<u>\$ 1.9</u>
Net Assets			
Invested in capital assets, net of related debt	\$ 246.6	\$ 237.9	\$ 8.7
Unrestricted	266.6	245.1	21.5
Total Net Assets	<u>\$ 513.2</u>	<u>\$ 483.0</u>	<u>\$ 30.2</u>

Change in Net Assets

The Department's total program revenues increased by 51.0% to \$16.4 million. (See Statement of Activities). 18.3% of the Department's program revenues come from loan interest income and 44.62% of the Department's program revenues come from the general lease program. A large portion of the revenue, approximately 37.1% of the revenue, comes from grants and contributions. Total general revenues increased by 12.4% to \$7.4 million due to an increase in State appropriations of \$0.6 million and a decrease in investment income of \$0.3 million. The total cost of the Department's program decreased by \$2.4 million, or 10.5%. The Department received \$30.0 million as part of the annual settlement payment with the State of Hawaii in accordance with Act 14, SP SLH 1995. Cash was transferred from the Department of Budget and Finance for the Hawaiian Home Lands settlement payment.

Statement of Activities

The Statement of Activities presents how the Department's net assets changed during the current fiscal year. Revenues and expenses are reported as soon as the underlying event occurs, regardless of the timing of the related cash flows. As such, the statement includes information for some items that will result in cash flows in future fiscal periods (e.g. uncollected lease payments).

The following is a comparative statement of changes in net assets:

Changes in Net Assets
(in millions)

	<u>2004</u>	<u>2003 (as restated)</u>	<u>Increase (Decrease)</u>
Revenues:			
Program Revenues			
Homestead Services	\$ 3.0	\$ 3.1	\$ (0.1)
Land Management	7.3	7.4	(0.1)
Sales of Homes	-	0.2	(0.2)
Intergovernmental Revenues	6.1	0.3	5.8
Appropriation (Net of Lapsed Appropriation)	1.8	1.1	0.7
Interest from Short-term Cash Investment	4.6	4.9	(0.3)
Other	<u>1.0</u>	<u>0.6</u>	<u>0.4</u>
Total Revenues	<u>23.8</u>	<u>17.6</u>	<u>6.2</u>
Expenses:			
Administration and support services	6.5	5.4	1.1
Homestead Services	17.2	11.8	5.4
Land Development	1.5	1.6	(0.1)
Land Management	1.2	1.6	(0.4)
Home Construction/Capital Projects	<u>-</u>	<u>2.1</u>	<u>(2.1)</u>
Total Expenditures	<u>26.4</u>	<u>22.5</u>	<u>3.9</u>
Excess (deficiency) of revenues over expenditures	(2.6)	(4.9)	2.3
Other Financing Sources			
Operating Transfer in/out (net)	<u>30.0</u>	<u>30.0</u>	<u>-</u>
Change in Net Assets	<u>27.4</u>	<u>25.1</u>	<u>2.3</u>
Net Assets, Beginning Year, as previously reported	485.8	484.1	1.7
Restatement of Infrastructure	<u>-</u>	<u>(23.4)</u>	<u>23.4</u>
Net Assets, Beginning Year, as restated	<u>485.8</u>	<u>460.7</u>	<u>25.1</u>
Net Assets, Ending Year	<u><u>\$ 513.2</u></u>	<u><u>\$ 485.8</u></u>	<u><u>\$ 27.4</u></u>

As noted, net assets increased \$27.4 million, a 4.7% growth this year. This amount is higher than fiscal 2003 when net assets increased \$25.1 million, a 5.5% growth. Total revenue increased 35.2% over last year and expenses increased by 17.3%. Major factor in revenue increasing 35.2% was:

- In fiscal year 2004, the Department is the recipient of annual block grants under the Native American Housing and Self-Determination Act (NAHASDA). The Department requested and received funding of \$6.1 million from NAHASDA and other federal funds

As noted earlier, expenses increased by 17.3%, largely due to increase activities in homestead services.

FINANCIAL ANALYSIS OF THE DEPARTMENT'S GOVERNMENTAL FUNDS

Governmental Funds

The focus of the Department's governmental funds is to provide information on short-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the Department's financing requirements. In particular, unreserved fund balances may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of the end of fiscal year 2004, the Department's governmental funds reported a combined increase in fund balance of \$23.1 million. The changes in fund balance for the governmental funds differ from the change in net assets for governmental activities. The differences relate to certain financial resources and expenditures such as debt financing and capital outlays that are included in the changes in fund balances but are not reported in the changes in net assets.

Comparison of Balance Sheets (in millions)

	Assets			Liabilities			Fund Balances		
	2004	2003	Change	2004	2003	Change	2004	2003	Change
General Fund	\$ 0.1	\$ 0.1	\$ -	\$ 0.1	\$ 0.1	\$ -	\$ -	\$ -	\$ -
General Loan Fund	63.2	61.8	1.4	3.0	1.9	1.1	60.2	59.9	0.3
Trust Fund	129.5	105.5	24.0	2.9	2.1	0.8	126.6	103.4	23.2
Federal Grants	0.8	-	0.8	0.8	-	0.8	-	-	-
Operating Fund	16.9	14.3	2.6	0.8	0.7	0.1	16.1	13.6	2.5
Receipts Fund	2.7	2.8	(0.1)	2.5	3.6	(1.1)	0.2	(0.8)	1.0
Administration Account	13.2	9.4	3.8	0.8	1.4	(0.6)	12.4	8.0	4.4
Temporary Deposits	2.0	1.6	0.4	1.8	1.4	0.4	0.2	0.2	-
Other Funds	49.4	57.8	(8.4)	0.1	0.2	(0.1)	49.3	57.6	(8.3)
Total	<u>\$277.8</u>	<u>\$253.3</u>	<u>\$24.7</u>	<u>\$ 12.8</u>	<u>\$ 11.4</u>	<u>\$ 1.6</u>	<u>\$265.0</u>	<u>\$241.9</u>	<u>\$ 23.1</u>

Comparison of Statement of Revenues, Expenditures and
Changes in Fund Balances
(in millions)

	Revenues			Expenditures			Net Change in Fund Balances		
	2004	2003	Change	2004	2003	Change	2004	2003	Change
General Fund	\$ 1.3	\$ 1.3	\$ -	\$ 1.2	\$ 1.2	\$ -	\$ -	\$ -	\$ -
General Loan Fund	-	-	-	0.4	(0.4)	0.8	0.3	0.6	(0.3)
Trust Fund	3.0	2.5	0.5	9.8	13.4	(3.6)	23.2	19.1	4.1
Federal Grants	6.0	-	6.0	6.0	-	6.0	-	-	-
Operating Fund	0.4	0.3	0.1	5.8	5.0	0.8	2.5	2.6	(0.1)
Receipts Fund	5.2	4.3	0.9	-	-	-	1.0	(1.2)	2.2
Administration Account	8.3	7.6	0.7	4.9	5.0	(0.1)	4.4	0.8	3.6
Temporary Deposits	-	-	-	-	-	-	-	-	-
Other Funds	1.5	1.3	0.2	4.3	3.0	(1.3)	(8.3)	(2.1)	(6.2)
Total	<u>\$ 25.7</u>	<u>\$ 17.3</u>	<u>\$ 8.4</u>	<u>\$ 32.4</u>	<u>\$ 27.2</u>	<u>\$ 5.2</u>	<u>\$ 23.1</u>	<u>\$ 19.8</u>	<u>\$ 3.3</u>

At the end of fiscal year 2004, the Hawaiian Home Lands Trust Fund reported an increase in the fund balance of \$23.2 million. The increase in the fund balance is the result of the receipt of the \$30 million from the Department of Budget and finance for the settlement as well as capital outlays declining from the previous year. The fund balance of the Hawaiian Home Operating Fund increased by \$2.5 million. The increase is the result of funds being transferred in from the Hawaiian Home Receipts Fund and the Hawaiian Home Administration Account. Overall, the assets for the Department increased by \$24.5 million and fund balance increased by \$23.1 million despite several funds declining in their values.

BUDGETARY HIGHLIGHTS

There was no reduction between the original budget and the final budget. Actual expenditures were less than budgetary estimates by \$143,892 or 11.1%. The favorable variance was created by expenditure control measures.

In the Hawaiian Home Administration Account, the actual revenue exceeded the budgeted amount by \$785,863 and expenditures were \$1.9 million less than the budgeted amount. The favorable variances were created by increased general lease collections and spending cuts.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

At the end of fiscal year 2004, the Department had invested \$339.6 million in a broad range of capital assets, including land, building, improvements, equipment and infrastructure. This amount represents a net increase (including additions, deductions and reclassifications) of \$16.8 million, or 5.2%, over last year.

In the prior year, the Department had capitalized certain infrastructure costs that had subsequently been reimbursed through the sale of homes or other arrangements. Those costs should not have been capitalized. Accordingly, the Department decreased its July 1, 2003 infrastructure balance by \$26,163,385, to eliminate the costs related to the infrastructure of the capital projects sold or reimbursed and reverse \$2,772,000 of accumulated depreciation relating to these costs. This adjustment is reflected in the fiscal 2003 balances shown below.

	Capital Assets (in millions)		
	2004	2003 (as restated)	Increase (Decrease)
Buildings and Improvements	\$ 9.0	\$ 8.5	\$ 0.5
Furniture and Equipment	0.6	0.4	0.2
Motor Vehicles	0.7	0.7	-
Infrastructure	255.7	247.9	7.8
Total Depreciable Assets	266.0	257.5	8.5
Less: Accumulated Depreciation	(80.5)	(68.3)	12.2
Net Depreciable Assets	185.5	189.2	(3.7)
Land	17.5	17.5	-
Construction in Progress	56.0	47.7	8.3
Total Capital Assets	\$ 259.0	\$ 254.4	\$ 4.6

In fiscal year 2004, the Department expended \$16.9 million for various capital projects. The Department has no plan to issue additional debt to finance these projects. Rather, the Department will continue to use its trust funds and federal funds to fund these projects.

Long-term Debt

At the end of fiscal year 2004, the Department had \$11.1 million in revenue bonds outstanding, all from the 1999 series revenue bonds. These revenue bonds will be paid off in year 2012. The Department is also obligated to repay a portion of the State general obligation bonds issued on the Department's behalf through Reimbursable General Obligation Bonds. The total obligation is \$1.3 million and will be paid in full through fiscal year 2016.

Outstanding Debt
(in millions)

	2004	2003	Increase (Decrease)
Revenue Bonds	\$ 11.1	\$ 12.3	\$ (1.2)
General Obligation Bonds	1.3	1.4	(0.1)
Total	<u>\$ 12.4</u>	<u>\$ 13.7</u>	<u>\$ (1.3)</u>

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

In the 2004-2005 budget, the general fund appropriation is \$0.8 million and reflects a decrease of \$521,714, or 44.2% from fiscal year 2004.

Revenues generated from general leases, revocable permits, licenses and right of entry agreements are projected to total \$7 million. This represents a 10% increase from the prior fiscal year. The increases are primarily due to new general lease dispositions and general lease rental re-openings.

SUBSEQUENT OR FUTURE EVENTS

In September 2004, the Department entered into a transfer agreement with the State of Hawaii in connection with the transfer of approximately 1,800 acres of land, consisting of four properties on three islands, to the Department. The land is partially developed and is intended to be utilized for 3,500 homes for native Hawaiians.

As part of the transfer agreement, the Department will pay \$2.2 million dollars a year for 15 years, for a total of \$33 million dollars, to reimburse the Housing and Community Development Corporation of Hawaii (HCDCH), State of Hawaii for infrastructure costs at three of the properties. While the payment does not cover the total cost HCDCH has invested into the properties, the Department plans to develop the properties and support the State's goal of providing affordable housing. Most of the 3,500 units is expected to be considered affordable and target native Hawaiians who are at 80 percent or below the median income level.

During fiscal 2004, the DHHL formulated a Strategic Plan that outlined four goals: Acceleration of lease awards, addressing the findings of the State Auditor's Report, attaining self-sufficiency, and perpetuating the trust.

In this connection, over the next three years, DHHL will begin construction on Master Planned Community (MPC) development projects on three islands, Hawaii, Maui, and Oahu. A total of 19 projects have been identified that is expected to produce an estimated 2,590 units with a total cost (including infrastructure) of approximately \$234.58 million. All of these projects are expected to be funded out of our existing budget. These MPC development plans reflect a new philosophy for the Department of building communities of 500-1,000 lots rather than historical small pocket type developments (ie. 50 lots).

In addition, we have developed four types of lease awards that should provide our beneficiaries with more planning time in their financial qualification for a home loan or relocating to another island. To assist with the financial qualification, the Department plans to partner with organizations that will assist in pre-homeownership training as well as post-loan training. The Department has experienced people, new programs, and partners in the community to work with our beneficiaries in fulfilling the commitment to our native Hawaiians.

Regarding the findings of the State Auditor's Report, since 2003, we have met twice to brief the State Auditor on our progress. We will continue to engage with the State Auditor on our progress in this matter.

FINANCIAL CONTACT

This financial report is designed to provide our citizens, taxpayers, lessees, investors and creditors with a general overview of the Department's finances and to demonstrate the Department's accountability for monies received. If there are any questions regarding this report or if additional financial information is required, please contact the Fiscal Office. The Department is located at 1099 Alakea Street, Suite 2000, Honolulu, Hawaii 96813.

Department of Hawaiian Home Lands

State of Hawaii

Statement of Net Assets

June 30, 2004

ASSETS

Cash and short-term cash investments held in State Treasury (Note C)	\$	221,480,756
Receivables (Note D):		
Loans, net of allowance for losses of \$4,042,000		45,755,204
Accrued interest		3,555,226
Note receivable		4,274,196
General leases and licenses, net of allowance for losses of \$1,287,000		376,763
Other		822,342
Other assets		1,554,700
Capital assets:		
Land, improvements, construction-in-progress and other capital assets, net of depreciation (Note I)		259,084,721
Total assets	\$	536,903,908

LIABILITIES

Vouchers and contracts payable	\$	4,272,228
Accrued wages and employee benefits payable (Note B)		373,232
Due to State Treasury		10,000
Other liabilities		5,026,037
Deferred revenue		480,075
Bonds payable (Note J):		
Due within one year		1,300,000
Due in more than one year		11,142,480
Accrued vacation (Note J):		
Due within one year		397,000
Due in more than one year		666,877
Total liabilities		23,667,929

Commitments and contingencies (Notes E, K ,L, M, N and O)

NET ASSETS

Invested in capital assets, net of related debt		246,642,241
Unrestricted		266,593,738
Total net assets		513,235,979
Total liabilities and net assets	\$	536,903,908

The accompanying notes are an integral part of the financial statements.

Department of Hawaiian Home Lands
State of Hawaii
Statement of Activities
for the year ended June 30, 2004

Functions/Programs	Expenses	Program Revenue		Net (Expense) Revenue and Changes in Net Assets
		Interest, Rents and Fees	Operating Grants and Contributions	
Departmental activities:				
Administration and support services	\$ 6,476,927	\$ -	\$ 379,053	\$ (6,097,874)
Homestead services	17,147,520	3,004,989	-	(14,142,531)
Land development	1,557,782	-	5,700,882	4,143,100
Land management	1,193,021	7,319,579	-	6,126,558
Total departmental activities	<u>\$ 26,375,250</u>	<u>\$ 10,324,568</u>	<u>\$ 6,079,935</u>	(9,970,747)
General revenues:				
Appropriations, net of lapsed appropriations of \$145,088				1,751,919
Interest from short-term cash investments				4,574,853
Other				<u>1,076,884</u>
Total general revenues before transfers				7,403,656
Transfers, net (Note L)				<u>30,000,000</u>
Total general revenues and transfers				<u>37,403,656</u>
Change in net assets				<u>27,432,909</u>
Net assets at July 1, 2003, as previously reported				509,194,455
Restatement of infrastructure (Note I)				<u>(23,391,385)</u>
Net assets at July 1, 2003, as restated				<u>485,803,070</u>
Net assets at June 30, 2004				<u>\$ 513,235,979</u>

The accompanying notes are an integral part of the financial statements.

Department of Hawaiian Home Lands
State of Hawaii
Balance Sheet
Governmental Funds
June 30, 2004

	General Fund	Hawaiian Home General Loan Fund	Hawaiian Home Lands Trust Fund	Hawaiian Home Operating Fund	Hawaiian Home Receipts Fund	Hawaiian Home Administration Account	Federal Grants	Temporary Deposits	Other Funds	Total
ASSETS										
Cash and short-term cash investments held in State Treasury (Note C)	\$ 86,020	\$ 20,295,649	\$ 124,694,040	\$ 16,838,340	\$ -	\$ 12,870,568	\$ 12,500	\$ 2,044,285	\$ 44,639,354	\$ 221,480,756
Receivables (Note D):										
Loans, net of allowance for losses of \$4,042,000	-	41,520,907	-	-	-	-	-	-	4,234,297	45,755,204
Accrued interest	-	-	609,872	21,062	2,641,799	(42,558)	-	-	325,051	3,555,226
Note receivable	-	-	4,274,196	-	-	-	-	-	-	4,274,196
General leases and licenses, net of allowance for losses of \$1,287,000	-	-	-	210	-	376,553	-	-	-	376,763
Other	-	19,727	-	48,959	-	2,328	737,016	-	14,312	822,342
Other assets	-	1,406,400	-	-	-	-	-	-	148,300	1,554,700
Total assets	<u>\$ 86,020</u>	<u>\$ 63,242,683</u>	<u>\$ 129,578,108</u>	<u>\$ 16,908,571</u>	<u>\$ 2,641,799</u>	<u>\$ 13,206,891</u>	<u>\$ 749,516</u>	<u>\$ 2,044,285</u>	<u>\$ 49,361,314</u>	<u>\$ 277,819,187</u>
LIABILITIES										
Vouchers and contracts payable	\$ -	\$ -	\$ 2,931,898	\$ 403,107	\$ -	\$ 89,243	\$ 762,114	\$ -	\$ 85,866	\$ 4,272,228
Accrued wages and employee benefits payable (Note B)	49,406	-	-	156,320	-	167,506	-	-	-	373,232
Due to State Treasury	10,000	-	-	-	-	-	-	-	-	10,000
Other liabilities	-	3,009,598	-	-	173,341	-	-	1,824,285	18,813	5,026,037
Deferred revenue	-	-	-	210,550	2,318,000	611,525	-	-	-	3,140,075
Total liabilities	<u>59,406</u>	<u>3,009,598</u>	<u>2,931,898</u>	<u>769,977</u>	<u>2,491,341</u>	<u>868,274</u>	<u>762,114</u>	<u>1,824,285</u>	<u>104,679</u>	<u>12,821,572</u>
Commitments and contingencies (Notes K, L, M, N, and O)										
FUND BALANCES										
Reserved for:										
Encumbrances	76,020	-	19,029,587	7,970,748	-	570,731	-	220,000	1,741,639	29,608,725
Receivables (Note D)	-	41,540,634	4,884,068	70,231	2,641,799	336,323	737,016	-	4,573,660	54,783,731
Loan commitments (Note E)	-	810,268	-	-	-	-	-	-	-	810,268
Unexpended Federal grants	-	-	-	-	-	-	2,910,966	-	-	2,910,966
Guaranteed and insured loans (Note K)	-	150,000	-	-	-	-	-	-	10,850,100	11,000,100
Total reserved fund balances	<u>76,020</u>	<u>42,500,902</u>	<u>23,913,655</u>	<u>8,040,979</u>	<u>2,641,799</u>	<u>907,054</u>	<u>3,647,982</u>	<u>220,000</u>	<u>17,165,399</u>	<u>99,113,790</u>
Unreserved	(49,406)	17,732,183	102,732,555	8,097,615	(2,491,341)	11,431,563	(3,660,580)	-	-	133,792,589
Unreserved reported in nonmajor:										
Special revenue funds	-	-	-	-	-	-	-	-	32,098,400	32,098,400
Capital projects fund	-	-	-	-	-	-	-	-	(7,164)	(7,164)
Total unreserved fund balances	<u>(49,406)</u>	<u>17,732,183</u>	<u>102,732,555</u>	<u>8,097,615</u>	<u>(2,491,341)</u>	<u>11,431,563</u>	<u>(3,660,580)</u>	<u>-</u>	<u>32,091,236</u>	<u>165,883,825</u>
Total fund balances	<u>26,614</u>	<u>60,233,085</u>	<u>126,646,210</u>	<u>16,138,594</u>	<u>150,458</u>	<u>12,338,617</u>	<u>(12,598)</u>	<u>220,000</u>	<u>49,256,635</u>	<u>264,997,615</u>
Total liabilities and fund balances	<u>\$ 86,020</u>	<u>\$ 63,242,683</u>	<u>\$ 129,578,108</u>	<u>\$ 16,908,571</u>	<u>\$ 2,641,799</u>	<u>\$ 13,206,891</u>	<u>\$ 749,516</u>	<u>\$ 2,044,285</u>	<u>\$ 49,361,314</u>	<u>\$ 277,819,187</u>

The accompanying notes are an integral part of the financial statements.

<p style="text-align: center;">Department of Hawaiian Home Lands State of Hawaii Statement of Revenues, Expenditures and Changes in Fund Balances Governmental Funds for the year ended June 30, 2004</p>										
	General Fund	Hawaiian Home General Loan Fund	Hawaiian Home Lands Trust Fund	Hawaiian Home Operating Fund	Hawaiian Home Receipts Fund	Hawaiian Home Administration Account	Federal Grants	Temporary Deposits	Other Funds	Total
Revenues										
Appropriations	\$ 1,297,007	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 600,000	\$ 1,897,007
General leases	-	-	-	-	-	6,189,378	-	-	-	6,189,378
Licenses and permits	-	-	-	-	-	1,725,201	-	-	-	1,725,201
Interest from loans and note receivable	-	-	-	163,273	4,028,716	-	-	-	-	4,191,989
Interest from short-term cash investments	-	-	2,477,744	22,659	1,175,737	274,493	-	-	624,220	4,574,853
Intergovernmental revenues	-	-	-	-	-	-	6,079,935	-	-	6,079,935
Other	-	-	546,647	215,419	-	72,791	-	-	242,027	1,076,884
Total revenues	1,297,007	-	3,024,391	401,351	5,204,453	8,261,863	6,079,935	-	1,466,247	25,735,247
Expenditures										
Current:										
Administration and support services	411,290	-	-	2,206,139	-	2,185,081	379,053	-	1,466,695	6,648,258
Homestead services	485,990	477,016	18,722	1,011,254	-	1,538,236	-	-	1,036,161	4,567,379
Land development	139,169	-	76,644	15,957	-	890,119	359,079	-	-	1,480,968
Land management	115,842	-	17,655	923,338	-	282,112	-	-	5,061	1,344,008
Capital outlay:										
Home construction/capital projects	-	-	9,666,321	1,453,345	-	16,208	5,354,401	-	112,462	16,602,737
Debt service:										
Principal on long-term debt	-	-	-	101,144	-	-	-	-	1,155,000	1,256,144
Interest on long-term debt	-	-	-	62,442	-	-	-	-	486,820	549,262
Total expenditures	1,152,291	477,016	9,779,342	5,773,619	-	4,911,756	6,092,533	-	4,262,199	32,448,756
Excess (deficiency) of revenues over (under) expenditures	144,716	(477,016)	(6,754,951)	(5,372,268)	5,204,453	3,350,107	(12,598)	-	(2,795,952)	(6,713,509)
Other financing sources (uses)										
Operating transfers in (Note L)	-	1,126,176	30,000,000	7,945,581	328,126	12,870,528	-	-	5,595,007	57,865,418
Operating transfers out	-	(328,127)	-	(19,287)	(4,540,156)	(11,841,828)	-	-	(11,136,020)	(27,865,418)
Total other financing sources (uses)	-	798,049	30,000,000	7,926,294	(4,212,030)	1,028,700	-	-	(5,541,013)	30,000,000
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	144,716	321,033	23,245,049	2,554,026	992,423	4,378,807	(12,598)	-	(8,336,965)	23,286,491
Lapsed appropriations	(145,088)	-	-	-	-	-	-	-	-	(145,088)
Net change in fund balances	(372)	321,033	23,245,049	2,554,026	992,423	4,378,807	(12,598)	-	(8,336,965)	23,141,403
Fund balances at July 1, 2003	26,986	59,912,052	103,401,161	13,584,568	(841,965)	7,959,810	-	220,000	57,593,600	241,856,212
Fund balances at June 30, 2004	\$ 26,614	\$ 60,233,085	\$ 126,646,210	\$ 16,138,594	\$ 150,458	\$ 12,338,617	\$ (12,598)	\$ 220,000	\$ 49,256,635	\$ 264,997,615

The accompanying notes are an integral part of the financial statements.

Department of Hawaiian Home Lands
State of Hawaii
Reconciliation of Governmental Funds Balance Sheet to the Statement of Net Assets
June 30, 2004

	Total Governmental Funds	Long-Term Assets, Liabilities	Reclassifications and Eliminations	Statement of Net Assets
ASSETS				
Cash and short-term cash investments held in State Treasury	\$ 221,480,756	\$ -	\$ -	\$ 221,480,756
Receivables:				
Loans, net of allowance for losses	45,755,204	-	-	45,755,204
Accrued interest	3,555,226	-	-	3,555,226
Note receivable	4,274,196	-	-	4,274,196
General leases and licenses, net of allowance for losses	376,763	-	-	376,763
Other	822,342	-	-	822,342
Other assets	1,554,700	-	-	1,554,700
Capital assets:				
Land, improvements, construction-in-progress and other capital assets, net of depreciation	-	259,084,721 (1)	-	259,084,721
Total assets	<u>\$ 277,819,187</u>	<u>\$ 259,084,721</u>	<u>\$ -</u>	<u>\$ 536,903,908</u>
LIABILITIES				
Vouchers and contracts payable	\$ 4,272,228	\$ -	\$ -	\$ 4,272,228
Accrued wages and employee benefits payable	373,232	-	-	373,232
Due to State Treasury	10,000	-	-	10,000
Other liabilities	5,026,037	-	-	5,026,037
Deferred revenue	3,140,075	(2,660,000) (4)	-	480,075
Bonds payable:				
Due within one year	-	1,300,000 (2)	-	1,300,000
Due in more than one year	-	11,142,480 (2)	-	11,142,480
Accrued vacation:				
Due within one year	-	397,000 (3)	-	397,000
Due in more than one year	-	666,877 (3)	-	666,877
Total liabilities	<u>12,821,572</u>	<u>10,846,357</u>	<u>-</u>	<u>23,667,929</u>
FUND BALANCES/NET ASSETS				
Invested in capital assets, net of related debt	-	277,822,288 (1) 16,946,250 (1) (86,666) (1) (12,205,766) (1) (23,391,385) (1) (13,695,051) (2) 1,256,144 (2) (3,573) (2)	-	246,642,241
Reserved/Restricted for:				
Encumbrances	29,608,725	-	(29,608,725) (5)	-
Receivables	54,783,731	-	(54,783,731) (5)	-
Loan commitments	810,268	-	(810,268) (5)	-
Unexpended Federal grants	2,910,966	-	(2,910,966) (5)	-
Guaranteed and insured loans	11,000,100	-	(11,000,100) (5)	-
Unreserved/Unrestricted:	165,883,825	(1,230,994) (3) 167,117 (3) 2,318,000 (4) 342,000 (4)	99,113,790 (5)	266,593,738
Total fund balances/net assets	<u>264,997,615</u>	<u>248,238,364</u>	<u>-</u>	<u>513,235,979</u>
Total liabilities and fund balances/net assets	<u>\$ 277,819,187</u>	<u>\$ 259,084,721</u>	<u>\$ -</u>	<u>\$ 536,903,908</u>

The accompanying notes are an integral part of the financial statements.

Department of Hawaiian Home Lands

State of Hawaii

Reconciliation of Governmental Funds Balance Sheet to the Statement of Net Assets

June 30, 2004 (continued)

Total fund balances - governmental funds	\$	264,997,615
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Amounts reported for governmental activities in the statement of net assets are different because:

- (1) Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds. These assets consist of:

Infrastructure assets	\$	255,737,344	
Other capital assets		10,339,525	
Accumulated depreciation		(80,493,044)	
Land		17,535,594	
Construction in progress		55,965,302	
Total capital assets			259,084,721

- (2) Bonds payable that are not due and payable in the current period are not reported in the funds. (12,442,480)

- (3) Compensated absences that are not due and payable in the current period are not reported in the funds. (1,063,877)

- (4) Lease rents and loan interest receivables are not available soon enough after year end to pay for the current period's expenditures and are therefore deferred in the funds. 2,660,000

- (5) Reclassify reserved fund balance/net assets to unrestricted fund balance/net assets. -

Total net assets	\$	513,235,979
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The accompanying notes are an integral part of the financial statements.

Department of Hawaiian Home Lands

State of Hawaii

Reconciliation of Governmental Funds Statement of Revenues, Expenditures and Changes in Fund Balances
to the Statement of Activities
for the year ended June 30, 2004

	Total Governmental Funds	Long-Term Assets, Liabilities	Reclassifications and Eliminations	Statement of Activities
Revenues				
Appropriations	\$ 1,897,007	\$ -	\$ (145,088) (5)	\$ 1,751,919
General leases	6,189,378	(595,000) (4)	-	5,594,378
Licenses and permits	1,725,201	-	-	1,725,201
Interest from loans and note receivable	4,191,989	(1,187,000) (4)	-	3,004,989
Interest from short-term cash investments	4,574,853	-	-	4,574,853
Intergovernmental revenues	6,079,935	-	-	6,079,935
Other	1,076,884	-	-	1,076,884
Total revenues	25,735,247	(1,782,000)	(145,088)	23,808,159
Expenditures				
Administration and support services	6,648,258	34,075 (1) (160,562) (1) 3,573 (2) (48,417) (3)	-	6,476,927
Homestead services	4,567,379	12,160,131 (1) (50,351) (1) (78,901) (3)	549,262 (6)	17,147,520
Land development	1,480,968	7,140 (1) 86,666 (1) (16,992) (3)	-	1,557,782
Land management	1,344,008	4,420 (1) (132,600) (1) (22,807) (3)	-	1,193,021
Home construction/capital projects	16,602,737	(16,602,737) (1)	-	-
Principal on long-term debt	1,256,144	(1,256,144) (2)	-	-
Interest on long-term debt	549,262	-	(549,262) (6)	-
Total expenditures	32,448,756	(6,073,506)	-	26,375,250
	(6,713,509)	(7,855,506)	(145,088)	(2,567,091)
Other financing sources and lapsed appropriations:				
Net operating transfers	30,000,000	-	-	30,000,000
Lapsed appropriations	(145,088)	-	145,088 (5)	-
Change in fund balances/net assets	\$ 23,141,403	\$ (7,855,506)	\$ -	\$ 27,432,909

The accompanying notes are an integral part of the financial statements

**Department of Hawaiian Home Lands
State of Hawaii**

Reconciliation of Governmental Funds Statement of Revenues, Expenditures and Changes in Fund Balances
to the Statement of Activities
for the year ended June 30, 2004 (continued)

Change in fund balances - governmental funds	\$ 23,141,403
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Amounts reported for governmental activities in the statement of activities are different because:

- (1) Capital outlays are reported as expenditures in governmental funds, however in the statement of activities, the cost of capital assets is allocated over their estimated useful lives as depreciation expense. In the current period, these outlays are:

Capital outlay	\$ 16,946,250	
Depreciation expense	(12,205,766)	
Expense asset additions under the capitalization threshold	<u>(86,666)</u>	
Excess of capital outlay over depreciation expenses		4,653,818

- (2) Repayment of bond principal is reported as an expenditure in governmental funds, but the repayment reduces bonds payable in the statement of net assets. Also, the increase in bonds payable due to premiums from refunding bonds is shown in the statement of net assets.

Repayment of bond principal	\$ 1,256,144	
Premium from refunding bonds issued	<u>(3,573)</u>	
Net bond repayments		1,252,571

- (3) The decrease in accrued vacation is reported in the statement of activities and does not require the use of current financial resources and is therefore not reported as expenditures in governmental funds. 167,117

- (4) Lease rent and loan interest that is not collected for several months after June 30 are not considered available revenues and are deferred in the governmental funds. Deferred revenues decreased by this amount in the current year. (1,782,000)

- (5) Lapsed appropriations are net against appropriations in the statement of activities. -

- (6) Reclassify interest from interest on long-term debt to Homestead Services Division. -

Change in net assets	<u><u>\$ 27,432,909</u></u>
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The accompanying notes are an integral part of the financial statements.

Department of Hawaiian Home Lands
State of Hawaii
Statement of Revenues and Expenditures - Budget and Actual
General Fund
for the year ended June 30, 2004

	Budgeted Amounts		Actual (Budgetary Basis)	Variance with Final Budget - Positive (Negative)
	Original	Final		
Appropriations	\$ 1,297,007	\$ 1,297,007	\$ 1,297,007	\$ -
Expenditures:				
Administration and support services	502,985	502,985	414,528	88,457
Homestead services	533,237	533,237	484,865	48,372
Land developement	138,379	138,379	137,880	499
Land management	122,406	122,406	115,842	6,564
Total expenditures	1,297,007	1,297,007	1,153,115	143,892
Excess of revenues over expenditures	\$ -	\$ -	\$ 143,892	\$ 143,892

The accompanying notes are an integral part of the financial statements.

Department of Hawaiian Home Lands
State of Hawaii
Statement of Revenues and Expenditures - Budget and Actual
Other Major Funds
for the year ended June 30, 2004

	Budgeted Amounts		Actual	Variance with
	Original	Final	(Budgetary Basis)	Final Budget - Positive (Negative)
<u>Hawaiian Home Administration Account</u>				
Revenues	\$ 7,476,000	\$ 7,476,000	\$ 8,261,863	\$ 785,863
Expenditures:				
Administration and support services	3,170,127	3,170,127	2,322,231	847,896
Homestead services	2,322,958	2,322,958	1,630,185	692,773
Land developement	1,096,770	1,096,770	899,507	197,263
Land management	522,988	522,988	372,464	150,524
Total expenditures	7,112,843	7,112,843	5,224,387	1,888,456
Excess of revenues over expenditures	\$ 363,157	\$ 363,157	\$ 3,037,476	\$ 2,674,319

The accompanying notes are an integral part of the financial statements.

Department of Hawaiian Home Lands
State of Hawaii

Notes to the Financial Statements
June 30, 2004

NOTE A - SIGNIFICANT ACCOUNTING POLICIES

The Department of Hawaiian Home Lands (DHHL), State of Hawaii (the State), is headed by the Hawaiian Homes Commission. The DHHL was established by Section 24, of Act 1 (the Hawaii State Government Reorganization Act of 1959), Second Special Session Laws of Hawaii 1959, and is responsible for the administration of the Hawaiian Homes Commission Act of 1920 enacted by the United States Congress. The Hawaiian Homes Commission Act (HHCA) sets aside certain public lands as Hawaiian Home Lands to be utilized in the rehabilitation of native Hawaiians.

The accompanying financial statements of the DHHL have been prepared in conformity with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB). In June 1999 the GASB issued Statement 34 Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments. This Statement establishes new financial reporting requirements for state and local governments throughout the United States of America. They require new information and restructure much of the information that governments have presented in the past. Comparability with reports issued in prior years is affected.

Other GASB Statements are required to be implemented in conjunction with GASB Statement 34. Therefore, the DHHL has implemented, if applicable, the following GASB Statements in the current year: Statement 33 – Accounting and Financial Reporting for Nonexchange Transactions, Statement 36 – Recipient Reporting for Certain Shared Nonexchange Revenues, Statement 37 – Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments: Omnibus and Statement 38 – Certain Financial Statement Note Disclosures.

The accompanying financial statements present the financial position of the DHHL and the various funds and fund types and the changes in financial position of the DHHL and the various funds and fund types. The financial statements are presented as of June 30, 2004, and for the year then ended. The financial statements include the public trusts controlled by the Hawaiian Homes Commission.

The following is a summary of significant accounting policies:

1. Reporting Entity - The DHHL is part of the executive branch of the State. The DHHL’s financial statements are intended to present the financial position and the changes in financial position, of only that portion of the governmental activities, each major fund, and the aggregate remaining fund information of the State that is attributable to the transactions of the DHHL. The State Comptroller maintains the central accounts for all State funds and publishes financial statements for the State annually which includes the DHHL’s assets, liabilities, net assets and financial activities.

Department of Hawaiian Home Lands
State of Hawaii

Notes to the Financial Statements
June 30, 2004

NOTE A - SIGNIFICANT ACCOUNTING POLICIES (continued)

2. Departmental and Governmental Fund Financial Statements – The departmental financial statements (the statement of net assets and the statement of activities) report information of all of the non-fiduciary activities of the DHHL. The effect of interfund activity has been removed from these departmental financial statements.

The statement of activities demonstrates the degree to which the direct expenses of a given function are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function. Program revenues include charges to customers who purchase, use or directly benefit from goods or services provided by a given function. Program revenues also include grants and contributions that are restricted to meeting the operational or capital requirements of a particular function. Appropriations and other items not properly included among program revenues are reported instead as general revenues. Resources that are dedicated internally are reported as general revenues rather than as program revenues.

Net assets are restricted when constraints placed on them are either externally imposed or are imposed by constitutional provisions or enabling legislation. At June 30, 2004, there were no restricted net assets.

Internally imposed designations of resources are presented as reserves of fund balances. Portions of fund balances are reserved for the following:

- Encumbrances - recorded obligations in the form of purchase orders or contracts.
- Receivables - amounts owed to DHHL at year end and are shown as reserved to indicate that portion of the fund balance that is not available for funding current expenditures.
- Loan commitments - loans approved before year end but funded after year end.
- Unexpended federal awards - encumbrances of federal awards not yet received from the federal government.
- Guaranteed and insured loans - amounts designated to pay mortgage guarantees and insurance claims.

Unreserved fund balances represents resources that have not been internally designated.

Financial statements are provided for DHHL's governmental funds. The DHHL has no proprietary funds or fiduciary funds. Major individual governmental funds are reported as separate columns in the governmental fund financial statements.

Department of Hawaiian Home Lands
State of Hawaii

Notes to the Financial Statements
June 30, 2004

NOTE A - SIGNIFICANT ACCOUNTING POLICIES (continued)

3. Measurement Focus, Basis of Accounting and Financial Statement Presentation –

Departmental Financial Statements – The departmental financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental Fund Financial Statements – The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the DHHL considers revenues to be available if they are collected within 60 days of the end of the current fiscal year end. Principal revenue sources considered susceptible to accrual include lease payments, sales, federal grants and interest on loans and investments, and loan principal and interest receivable. Some revenue items that are considered measurable and available to finance operations during the year from an accounting perspective are not available for expenditure due to the State's present appropriation system. These revenues have been accrued in accordance with accounting principles generally accepted in the United States of America since they are both measurable and are expected to be collected within sixty days of the end of the period.

Expenditures generally are recorded when a liability is incurred, as under accrual accounting. Exceptions include:

- Employees' vested annual leave which is recorded as an expenditure when utilized. The amount of accumulated annual leave unpaid at June 30, 2004, has been reported only in the departmental financial statements.
- Interest on bonds payable which is recognized when paid.

4. Fund Accounting – The accounts of the DHHL are organized on the basis of funds, each of which is considered a separate accounting entity. The financial activities of each fund are accounted for with a separate set of self-balancing accounts which represent each funds' assets, liabilities, fund equity, revenues and expenditures.

Department of Hawaiian Home Lands
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Notes to the Financial Statements

June 30, 2004

NOTE A - SIGNIFICANT ACCOUNTING POLICIES (continued)

The financial activities of the DHHL that are reported in the accompanying governmental fund financial statements have been classified into the following major governmental funds:

General fund – The general fund is used to account for all financial activities except those required to be accounted for in another fund. The annual operating budget as authorized by the State Legislature provides the basic framework within which the resources and obligations of the general fund are accounted for.

Special revenue funds – Special revenue funds are used to account for proceeds of specific revenue sources (other than expendable trust) that are restricted to expenditures for specified purposes. Revenues are primarily from general leases, licenses and permits granted for commercial, residential, agricultural and pastoral uses, and interest and investment income. DHHL's major special revenue funds are as follows:

Hawaiian Home General Loan Fund – This fund accounts for DHHL loans made to native Hawaiian homesteaders.

Hawaiian Home Operating Fund – This fund accounts for operations of the DHHL and is funded by monies transferred from the Hawaiian Home Receipts Fund.

Hawaiian Home Receipts Fund – This fund accounts for receipts of investment interest and loan interest payments from DHHL loans to homesteaders.

Hawaiian Home Administration Account – This fund accounts for commercial general leases, revocable permits and licenses of homestead lands. Lease revenues are used to fund operations of the DHHL.

Federal Grants – This fund accounts for grants the DHHL has with the Federal Government.

Temporary Deposits – This fund accounts for refundable deposits to lessees of homestead lands.

Hawaiian Home Lands Trust Fund – This expendable trust fund accounts for funds from the State to be expended by the DHHL as provided by law upon approval by the Commission and used for capital improvements and other purposes undertaken in furtherance of the Hawaiian Homes Commission Act of 1920.

Department of Hawaiian Home Lands

State of Hawaii

Notes to the Financial Statements

June 30, 2004

NOTE A - SIGNIFICANT ACCOUNTING POLICIES (continued)

5. Appropriations - An authorization granted by the State Legislature permitting a State agency, within established fiscal and budgetary controls, to incur obligations and to make expenditures. Appropriations are allotted quarterly. The allotted appropriations lapse if not expended by or encumbered at the end of the fiscal year, except for allotted appropriations related to capital projects.
6. Encumbrances - Encumbrance accounting, under which purchase orders, contracts and other commitments for the expenditure of monies are recorded in order to reserve that portion of the applicable appropriation, is employed as an extension of formal budgetary integration in the governmental fund types. Encumbrances outstanding at fiscal year end are reported as reservations of fund balances since they do not constitute expenditures or liabilities.
7. Cash and Short-term Cash Investments - Cash and short-term cash investments reported in the statement of net assets and the governmental funds balance sheet consist of cash and short-term cash investments in the State Treasury.

The State of Hawaii maintains a cash pool that is available for all funds. Each fund type's portion of this pool is displayed on the statement of net assets and the governmental funds balance sheet within cash and short-term cash investments. Those funds are pooled with funds from other State agencies and departments and deposited in approved financial institutions by the State Director of Finance. Deposits not covered by federal deposit insurance are fully collateralized by government securities held in the name of the State by third party custodians. Interest income from this cash pool is allocated to the various departments and agencies based upon their average cash balance for the period.

The Hawaii Revised Statutes (HRS) authorized the State Director of Finance to invest in obligations of or obligations guaranteed by, the U.S. Government, obligations of the State, federally-insured savings and checking accounts, time certificates of deposit and repurchase agreements with federally-insured financial institutions.

8. Accumulated Vacation and Sick Leave - Eligible employees are credited with vacation at a rate of 168 hours per calendar year. Accumulation of such vacation credits is limited to 720 hours at calendar year-end. The governmental fund financial statements record expenditures when employees are paid for leave. The departmental financial statements present the cost of accumulated vacation leave as a liability. Liabilities for vacation pay are inventoried at the end of each accounting period and adjusted to current salary levels.

Department of Hawaiian Home Lands

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Notes to the Financial Statements

June 30, 2004

NOTE A - SIGNIFICANT ACCOUNTING POLICIES (continued)

Eligible employees are credited with sick leave at a rate of one and three-quarter days per month of service. Unused sick leave may be accumulated without limit but can be taken only in the event of illness or other incapacitation and is not convertible to pay upon termination of employment. Accordingly, accumulated sick leave is not included in the DHHL's statement of net assets or governmental fund balance sheet. However, an employee who retires or leaves government service in good standing with sixty days or more in unused sick leave is entitled to additional service credit in the Employees' Retirement System of the State of Hawaii (ERS). Accumulated sick leave as of June 30, 2004, was approximately \$3,188,800.

9. Intrafund and Interfund Transactions - Significant transfers of financial resources between activities and appropriations included within the same fund are eliminated. Transfers of revenues from funds authorized to receive them to funds authorized to expend them have been recorded as operating transfers in the financial statements.

All interfund transfers are reflected in the governmental fund financial statements but are eliminated in the departmental financial statements.

10. Inventory - Inventory of materials and supplies is recorded as expenditures when purchased.
11. Capital Assets - To be in compliance with GASB Statement 34, at July 1, 2001, DHHL capitalized infrastructure such as streets, gutters, curbs, sidewalks, draining and lighting systems. Capital assets which include land, buildings, improvements, equipment and infrastructure assets are reported in the departmental financial statements. Capital assets are assets which have a cost of \$5,000 or more at the date of acquisition and have an expected useful life of five or more years. Purchased and constructed capital assets are valued at historical cost or estimated historical cost. Donated fixed assets are recorded at their fair market value at the date of donation.

Capital assets utilized in the governmental funds are recorded as expenditures in the governmental fund financial statements. Depreciation expense is recorded in the departmental financial statements.

Department of Hawaiian Home Lands

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Notes to the Financial Statements

June 30, 2004

NOTE A - SIGNIFICANT ACCOUNTING POLICIES (continued)

Capital assets are depreciated on the straight-line method over the assets' estimated useful life. There is no depreciation recorded for land and construction in progress. Generally, estimated useful lives are as follows:

Machinery and equipment	5 – 7 years
Vehicles	5 years
Buildings and other improvements	15 – 40 years
Infrastructure	30 years

Certain office space is provided by the Department of Accounting and General Services, State of Hawaii, at no cost to the DHHL.

The DHHL also has land in various parts of the State, some of which were transferred to it at no cost or at nominal cost.

12. General Leases and Licenses - General leases and licenses received in advance are recognized on a straight-line basis over the lease or license term.
13. Lease Rents and Interest Income - The DHHL's governmental fund financial statements recognizes lease rent and mortgage interest of its governmental funds as revenues when they are measurable and available. Revenues are measurable when they are subject to reasonable estimation. The available criterion is satisfied when revenues are collectible during the period and the actual collection will occur either during the period or after the end of the period, but in time to pay fund liabilities. The DHHL considers revenues available if they are expected to be collected within 60 days of the end of the year. Amounts not collected within this period approximated \$2,660,000 as of June 30, 2004, and are recorded as deferred revenue. The departmental financial statements present lease rents and mortgage interest under the accrual method of accounting.
14. Use of Estimates - In preparing financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

Department of Hawaiian Home Lands

State of Hawaii

Notes to the Financial Statements

June 30, 2004

NOTE B - BUDGETING AND BUDGETARY CONTROL

The DHHL's annual budget is prepared on the cash basis utilizing encumbrance accounting. Revenue estimates are provided to the State Legislature at the time of budget consideration and are revised and updated throughout the fiscal year. Amounts reflected by the DHHL as budgeted revenues are those estimates as compiled by the State Director of Finance. Budgeted expenditures for the DHHL's general fund and the Hawaiian Homes Administration Account, a DHHL special revenue fund, are provided to the Department of Budget and Finance, State of Hawaii, for accumulation with budgeted amounts of the other State agencies and included in the Governor's executive budget that is subject to legislative approval. In addition, the budget for all expenditures of the DHHL's funds are also presented annually to the Hawaiian Homes Commission for approval.

To the extent not expended or encumbered, general fund appropriations generally lapse at the end of the fiscal year for which the appropriations were made. The State Legislature specifies the lapse date and any other particular conditions relating to terminating the authorization for other appropriations.

For purposes of budgeting, the DHHL's budgetary fund structure and accounting principles differ from those utilized to present the financial statements in conformity with accounting principles generally accepted in the United States of America. Since the budgetary basis differs from accounting principles generally accepted in the United States of America, budget and actual amounts in the statement of revenues and expenditures – budget and actual – general fund, are presented on the budgetary basis. A reconciliation of general fund revenues in excess of expenditures on a budgetary basis for the year ended June 30, 2004, to general fund revenues in excess of expenditures presented in conformity with accounting principles generally accepted in the United States of America, is set forth below.

Under Section 78-13 HRS, staff salaries and wages amounting to \$47,618 and \$167,506 in the general fund and Hawaiian Home Administration Account, respectively, for the period from June 16, 2004 through June 30, 2004, are to be funded with monies budgeted for fiscal year 2005. Accordingly, these amounts are excluded from the statements of revenues and expenditures – budget and actual of the general fund and Hawaiian Home Administration Account. For accounting purposes these amounts are reflected in the departmental and governmental fund financial statements at June 30, 2004, in accordance with accounting principles generally accepted in the United States of America.

In fiscal year 2003, under section 78-13 HRS salaries and wages for the period from June 16, 2003 to June 30, 2003, were funded with monies budgeted for fiscal year 2004. Accordingly, these amounts are included in the statements of revenues and expenditures – budget and actual of the general fund and Hawaiian Home Administration Account, for the year ended June 30, 2004. These salaries, and wages, aggregated \$46,009 for the general fund and \$158,477 for the Hawaiian Home Administration Account.

Department of Hawaiian Home Lands

State of Hawaii

Notes to the Financial Statements

June 30, 2004

NOTE B - BUDGETING AND BUDGETARY CONTROL (continued)

The following schedule reconciles the budgetary amounts of the general fund and the Hawaiian Home Administration Account to the amounts presented in accordance with accounting principles generally accepted in the United States of America (GAAP basis).

	General Fund	Hawaiian Home Administration Account
Excess of revenues over expenditures - actual on budgetary basis	\$ 143,892	\$ 3,037,476
Current year's appropriations included in reserved for encumbrances at June 30, 2004	5,305	459,790
Expenditures for liquidation of prior years' encumbrances	(2,872)	(138,130)
Fiscal 2003 salaries and wages funded by fiscal 2004 budget	46,009	158,477
Fiscal 2004 salaries and wages funded by fiscal 2005 budget under Section 78-13 HRS	<u>(47,618)</u>	<u>(167,506)</u>
Excess of revenues over expenditures - GAAP basis	<u>\$ 144,716</u>	<u>\$ 3,350,107</u>

NOTE C - CASH AND SHORT-TERM CASH INVESTMENTS

Cash and short-term cash investments includes monies in the State Treasury. The State Treasury maintains an investment pool for all state monies. Hawaii Revised Statutes (HRS) authorize the State Director of Finance to invest any monies of the State which in the Director's judgment are in excess of amounts necessary for meeting the immediate requirements of the State. Legally authorized investments include obligations of or guaranteed by the U.S. Government, obligations of the State, federally-insured savings and checking accounts, time certificates of deposit and repurchase agreements with federally-insured financial institutions.

Information relating to the bank balance, insurance and collateral of cash deposits is determined on a statewide basis and not for individual departments or divisions.

As of June 30, 2004, the carrying amount, which approximates the bank balance, of the DHHL's cash and short-term cash investments was \$221,480,756.

Department of Hawaiian Home Lands

State of Hawaii

Notes to the Financial Statements

June 30, 2004

NOTE D - RECEIVABLES

As of June 30, 2004, receivables consisted of the following:

Loans (Note E)	\$ 49,797,204
Allowance for losses	(4,042,000)
Accrued interest	3,555,226
Note receivable (Note F)	4,274,196
General leases and licenses (Note G)	1,663,763
Allowance for losses	(1,287,000)
Other	822,342
	<u>\$ 54,783,731</u>

As of June 30, 2004, general leases and licenses receivable included installment agreements with eight lessees with an aggregate balance of approximately \$405,000. The agreements provide for varying monthly or quarterly payments, accrued interest at 10% per annum and varying terms extending through March 2009.

NOTE E - LOANS RECEIVABLE

Loans receivable consist of approximately 1,700 loans made to native Hawaiian lessees for the purposes specified in the Hawaiian Homes Commission Act. Loans are for a maximum amount of approximately \$192,000 and for a maximum term of 30 years. Interest rates on outstanding loans range from 2.5% to 10.0%. The DHHL's loan portfolio consists of loans that the DHHL has originated and that generally are collateralized by improvements on the leased properties located in the State. Loan commitments as of June 30, 2004 were \$810,268. The DHHL has provided an allowance for loan losses as of June 30, 2004. The allowance for loan losses is a valuation reserve, which has been provided through charges to operations. This charge to operations is the amount necessary, in the opinion of management, to maintain the balance in the allowance for loan losses at a level adequate to absorb potential losses for loans in the loan portfolio as of June 30, 2004.

Department of Hawaiian Home Lands

State of Hawaii

Notes to the Financial Statements

June 30, 2004

NOTE F – NOTE RECEIVABLE

The DHHL has a note receivable from the developer of the DHHL's Waimanalo Kupuna Housing Project in the amount of \$4,274,196. The DHHL paid development costs for this project and will be reimbursed after the developer obtains permanent financing for the project. The note is non-interest bearing and is due 18 months after the completion of the project.

NOTE G – GENERAL LEASES AND LICENSES

The DHHL's general leasing operations (Section 204 of Hawaiian Homes Commission Act of 1920, as amended) consist principally of the leasing of its Hawaiian Home Lands. The general leases have varying terms extending through 2066.

The future minimum lease income from general leases as of June 30, 2004, is as follows:

<u>Year ending June 30,</u>	
2004	\$ 6,529,000
2005	6,511,000
2006	6,558,000
2007	6,693,000
2008	6,927,000
Thereafter	<u>208,396,000</u>
	<u>\$ 241,614,000</u>

As of June 30, 2004, approximately 60% of the DHHL's land (based on acreage) was under homestead or general leases and license agreements. The cost of this land was not significant.

NOTE H - SALE OF HOMES

Under certain circumstances, the DHHL purchases homes from former lessees due to voluntary and involuntary cancellations of land leases. The homes are subsequently resold to qualified lessees. During the year ended June 30, 2004, the DHHL had purchased homes from former lessees with costs aggregating \$1,404,700.

Department of Hawaiian Home Lands
State of Hawaii

Notes to the Financial Statements
June 30, 2004

NOTE I – CAPITAL ASSETS

Capital assets activity for the year ended June 30, 2004, was as follows:

	Beginning Balance July 1, 2003 (previously reported)	Adjustments	Beginning Balance July 1, 2003 (restated)	Additions, Disposals Adjustments, and Transfers	Ending Balance June 30, 2004
Capital assets not being depreciated					
Land	\$ 17,535,594	\$ -	\$ 17,535,594	\$ -	\$ 17,535,594
Construction-in- progress	47,689,009	-	47,689,009	16,602,737 (86,666) (8,239,778)	55,965,302
Total capital assets, not being depreciated	65,224,603	-	65,224,603	8,276,293	73,500,896
Capital assets being depreciated -					
Buildings and improvements	8,468,778	-	8,468,778	132,600 421,845	9,023,223
Infrastructure	274,082,796	(26,163,385)	247,919,411	7,817,933	255,737,344
Furniture and equipment	429,497	-	429,497	177,361	606,858
Motor vehicles	688,067	-	688,067	33,552 (12,175)	709,444
Total capital assets, being depreciated	283,669,138	(26,163,385)	257,505,753	8,571,116	266,076,869
Less: accumulated depreciation -					
Buildings and improvements	(2,719,632)	-	(2,719,632)	(312,966)	(3,032,598)
Infrastructure	(67,371,652)	2,772,000	(64,599,652)	(11,830,697)	(76,430,349)
Furniture and equipment	(345,074)	-	(345,074)	(34,363)	(379,437)
Motor vehicles	(635,095)	-	(635,095)	(27,740) 12,175	(650,660)
Total accumulated depreciation	(71,071,453)	2,772,000	(68,299,453)	(12,193,591)	(80,493,044)
Total capital assets, being depreciated, net	212,597,685	(23,391,385)	189,206,300	(3,622,475)	185,583,825
Capital assets, net	\$ 277,822,288	\$ (23,391,385)	\$ 254,430,903	\$ 4,653,818	\$ 259,084,721

Department of Hawaiian Home Lands

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Notes to the Financial Statements

June 30, 2004

NOTE I – CAPITAL ASSETS (continued)

In the prior year, the DHHL had capitalized certain infrastructure costs which had subsequently been reimbursed through the sale of homes or other arrangements. These costs should not have been capitalized. Accordingly, the DHHL decreased its July 1, 2003 infrastructure balance by \$26,163,385, to eliminate the costs related to the infrastructure of the capital projects sold or reimbursed and reverse \$2,772,000 of accumulated depreciation relating to these costs. This resulted in a \$23,391,985 restatement to the July 1, 2003 net assets invested in capital assets.

Other changes to capital assets consisted of the following:

Additions:

Capital outlays and equipment purchases	\$ 16,946,250
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Disposals:

Disposed capital assets, at cost	\$ 12,175
Accumulated depreciation of disposed capital assets	(12,175)
	<u>\$ -</u>

Adjustments:

Expense completed construction contracts, less than the capitalization threshold	\$ (86,666)
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Depreciation expense for the year ended June 30, 2004, was charged to functions of the DHHL as follows:

Administration and support services	\$ 34,075
Homestead services	12,160,131
Land development	7,140
Land management	<u>4,420</u>
Total depreciation	<u>\$ 12,205,766</u>

NOTE J – LONG-TERM OBLIGATIONS

For the year ended June 30, 2004, changes in long-term obligations were as follows:

	Accrued Vacation	Bonds Payable
Balances at July 1, 2003	\$ 1,230,994	\$ 13,695,051
Principal payments	-	(1,256,144)
Bond issued		7,415
Bonds refunded	-	(3,842)
Net decrease in accrued vacation	<u>(167,117)</u>	<u>-</u>
Balances at June 30, 2004	<u>\$ 1,063,877</u>	<u>\$ 12,442,480</u>

Department of Hawaiian Home Lands
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Notes to the Financial Statements
June 30, 2004

NOTE J- LONG-TERM OBLIGATIONS (continued)

Obligations for accrued vacation are generally liquidated by the general fund, the Hawaiian Home Operating Fund and the Hawaiian Home Administration Account.

Bonds Payable

Revenue Bonds -

The State Legislature, by Act 316, SLH 1989, as amended by Act 299, SLH 1990, and further amended by Act 296, SLH 1991, authorized the issuance of revenue bonds amounting to \$43,768,000 to finance the cost of developing Hawaiian home lands. Of the total amount authorized, the DHHL issued \$18,000,000 of 1991 series revenue bonds in October 1991.

On January 15, 1999, the DHHL issued \$13,370,000 of 1999 series revenue bonds to advance refund \$12,060,000 of outstanding 1991 series revenue bonds. The net proceeds of \$13,055,195, after payment of issuance cost and \$207,950 of the DHHL's funds, were used to purchase U.S. government securities. Those securities were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the 1991 series revenue bonds. As a result, the 1991 series revenue bonds are considered to be defeased and the liability for those bonds has been removed from the general long-term debt account.

The revenue bonds are payable from and collateralized by the DHHL's revenues from available lands and are due in annual installments through July 1, 2011. The balance of bonds payable as of June 30, 2004, is \$11,100,000 for the 1999 series revenue bonds.

The unrefunded series 1991 bonds were repaid on July 1, 2001.

Interest on the series 1999 bonds increases annually from 3.8% to 4.45% and is payable semi-annually on January 1 and July 1. Commencing on July 1, 2002, annual principal payments were required.

The annual requirements of the revenue bonds are as follows:

<u>Year ending June 30,</u>	<u>Interest</u>	<u>Principal</u>	<u>Total</u>
2005	\$ 440,298	\$ 1,200,000	\$ 1,640,298
2006	391,298	1,250,000	1,641,298
2007	339,973	1,300,000	1,639,973
2008	285,870	1,355,000	1,640,870
2009	228,835	1,410,000	1,638,835
2010	168,446	1,465,000	1,633,446
2011	104,146	1,525,000	1,629,146
2012	35,489	1,595,000	1,630,489
Total	<u>\$ 1,994,355</u>	<u>\$ 11,100,000</u>	<u>\$ 13,094,355</u>

Department of Hawaiian Home Lands

State of Hawaii

Notes to the Financial Statements

June 30, 2004

NOTE J - LONG-TERM OBLIGATIONS (continued)

Bonds Payable (continued)

General Obligation Bonds -

The following are portions of the State general obligation bonds allocated to the DHHL under acts of various Session Laws of Hawaii. These bonds are backed by the full faith, credit and taxing power of the State. Repayments of allocated bond debts are made to the State General Fund. Details of the allocated bonds as of June 30, 2004, are as follows:

\$1,000,346 Series BW bonds dated March 1, 1992; \$166,708 was refunded on February 15, 2002; due in annual principal installments of \$55,569 commencing March 1, 2006 through March 1, 2012; interest at 5.875% to 6.40% payable semi-annually	\$ 388,984
\$124,303 Series BZ bonds dated October 1, 1992; \$7,769 was refunded on April 1, 1998 and \$23,307 was refunded on February 15, 2002; due in annual principal installments of \$7,769 commencing October 1, 2005 through October 1, 2012; interest at 5.40% to 6.25% payable semi-annually	62,151
\$758,726 Series CI refunding bonds dated November 1, 1993; due in annual principal installments of \$50,587 through November 1, 2003 and \$50,575 through November 1, 2010; interest at 4.20% to 4.90% payable semi-annually	354,028
\$66,394 Series CH bonds dated November 1, 1993; \$55,335 was refunded on October 1, 1997; due in annual principal installments of \$3,689 through November 1, 2013; interest at 4.10% to 6.00% payable semi-annually	33,194
\$86,517 Series CO bonds dated March 1, 1997; \$11,940 was refunded on April 1, 1998; due in semi-annual principal installments of \$2,646 to \$4,250 through March 1, 2011; interest at 4.625% to 6.00% payable semi-annually	<u>49,456</u>
Subtotal carried forward	\$ 887,813

Department of Hawaiian Home Lands
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Notes to the Financial Statements
June 30, 2004

NOTE J - LONG-TERM OBLIGATIONS (continued)

Bonds Payable (continued)

General Obligation Bonds (continued) -

Subtotal brought forward	\$ 887,813
\$1,062 Series CQ refunding bonds dated October 1, 1997; due in annual principal installments of \$158 to \$174 through October 1, 2004; interest at 4.25% to 5.00% payable semi-annually	175
\$321,472 Series CS refunding bonds dated April 1, 1998; due in annual principal installments of \$39,227 on April 1, 2003; \$41,289 on April 1, 2004; \$43,457 on April 1, 2005; \$45,740 on April 1, 2006; \$48,137 on April 1, 2007; \$50,548 on April 1, 2008 and \$53,074 on April 1, 2009; interest at 5.00% to 5.25% payable semi-annually	240,956
\$65,992 Series CW refund bonds dated August 1, 2001; due in annual principal installments of \$4,679 on August 1, 2005; \$4,873 on August 1, 2006; \$5,073 on August 1, 2007; \$5,311 on August 1, 2008; \$5,585 on August 1, 2009; \$5,885 on August 1, 2010; \$6,203 on August 1, 2011; \$6,540 on August 1, 2012; \$6,896 on August 1, 2013; \$7,273 on August 1, 2014; \$7,674 on August 1, 2015	65,992
\$140,129 Series CY refunding bonds dated February 15, 2002; due in annual principal installments of \$12,633 on February 1, 2007; \$13,217 on February 1, 2008; \$13,910 on February 1, 2009; \$14,582 on February 1, 2010; \$15,347 on February 1, 2011; \$16,192 on February 1, 2012; \$17,081 on February 1, 2013; \$18,064 on February 1, 2014 and \$19,104 on February 1, 2015; interest at 3.60% to 5.75% payable semi-annually	140,129
\$7,415 Series DB refunding bonds dated September 16, 2003; due in annual principal installments of \$675 on September 1, 2008; \$703 on September 1, 2009; \$738 on September 1, 2010; \$778 on September 1, 2011; \$815 on September 1, 2012; \$857 on September 1, 2013; \$902 on September 1, 2014; \$949 on September 1, 2015 and \$1,000 on September 1, 2016; interest at 5.00% to 5.25% payable semi-annually	7,415
	<u>\$ 1,342,480</u>

At June 30, 2004, all of the remaining principal had been spent on capital projects.

Department of Hawaiian Home Lands
State of Hawaii

Notes to the Financial Statements

June 30, 2004

NOTE J- LONG-TERM OBLIGATIONS (continued)

Bonds Payable (continued)

General Obligation Bonds (continued) -

The annual requirements of the general obligation bonds are as follows:

<u>Year ending June 30,</u>	<u>Interest</u>	<u>Principal</u>	<u>Total</u>
2005	\$ 57,937	\$ 100,084	\$ 158,021
2006	53,654	174,256	227,910
2007	45,413	189,858	235,271
2008	36,803	193,455	230,258
2009	28,012	198,015	226,027
2010	19,894	146,368	166,262
2011	12,419	147,950	160,369
2012	6,255	90,197	96,452
2013	1,783	35,893	37,676
2014	982	29,505	30,487
2015	480	27,277	27,757
2016	41	8,622	8,663
2017	3	1,000	1,003
	<u>\$ 263,676</u>	<u>\$ 1,342,480</u>	<u>\$ 1,606,156</u>

NOTE K - COMMITMENTS AND CONTINGENCIES

Litigation -

The DHHL is involved in several lawsuits and complaints which management believes arose in the normal course of operations. Based on discussions with counsel, management has ascertained that lawsuits and complaints against the State of Hawaii are typically paid through an appropriation from the General Fund of the State of Hawaii. Accordingly, management is of the opinion that the outcome of these lawsuits and complaints will not have a material adverse effect on the financial position of the DHHL.

Insurance -

Insurance coverage is maintained at the State level. The State is substantially self-insured for all perils including workers' compensation. Effective July 1, 1997, all benefits paid for workers' compensation are reflected in the respective department or agency's financial statements. No benefits were paid by the DHHL for the year ended June 30, 2004. Expenditures for other insurance claims are made by the Department of Accounting and General Services, State of Hawaii, and are not reflected in the DHHL financial statements. Workers' compensation benefit claims reported, as well as incurred but not reported, were reviewed at year end. The estimated losses from these claims are not material.

Department of Hawaiian Home Lands

State of Hawaii

Notes to the Financial Statements

June 30, 2004

NOTE K - COMMITMENTS AND CONTINGENCIES (continued)

Deferred Compensation Plan -

In 1983, the State established a deferred compensation plan which enables State employees to defer a portion of their compensation. The Department of Human Resources Development, State of Hawaii, has the fiduciary responsibility of administering the plan. The plan assets are protected from claims of the State's creditors and from diversion to any uses other than paying benefits to participants and beneficiaries. The deferred compensation is not available to employees until termination, retirement, death or any unforeseeable emergency.

Guaranteed and Insured Loans -

As of June 30, 2004, the DHHL was contingently liable for approximately \$10,172,000 in loans originated primarily by the U.S. Department of Agriculture Rural Development for which the DHHL has guaranteed repayment. A total of \$1,325,000 of these loans has been reported delinquent as of June 30, 2004.

The DHHL is also a party to a mortgage loan insurance agreement with the U.S. Department of Housing and Urban Development (HUD). The agreement provides that HUD will perform underwriting processing for the insurance of mortgage and will administer an insurance fund for mortgages originated and held by HUD-approved lenders. The DHHL will maintain and provide the necessary and proper funds for payment of any mortgage insurance claims and expenditures incurred by HUD in connection with the lessee borrowers. The DHHL has reserved cash of approximately \$10,850,100 in the special revenue fund and has deposited \$150,000 with HUD. As of June 30, 2004, loans outstanding totaled approximately \$210,498,000 under this agreement, of which \$8,700,000 has been reported as delinquent.

As of June 30, 2004, the DHHL is also contingently liable for approximately \$23,484,000 in loans originated by financial institutions and other lenders for which it has guaranteed repayment. A total of \$2,801,000 of these loans has been reported delinquent as of June 30, 2004.

As of June 30, 2004, the DHHL paid approximately \$4,965,000 for delinquent mortgage loan payments of lessees. These payments are carried as loans receivable from lessees and bear similar terms as stipulated in the lessees' mortgage note with the lenders.

The DHHL has certain loans for which the collateral for the loans is not covered by casualty insurance. The number of such loans is not known.

Other -

As of June 30, 2004, the reserve for encumbrances relating to construction contracts approximated \$28,026,000.

Department of Hawaiian Home Lands

State of Hawaii

Notes to the Financial Statements

June 30, 2004

NOTE L - COMPENSATION FOR PAST USE OF HAWAIIAN HOME LANDS BY THE STATE OF HAWAII

Pursuant to Act 14, SP SLH 1995, the Hawaiian Home Lands Trust Fund was established to account for funds to be paid by the State for the use or disposition of lands, which were alleged to have been Hawaiian home lands or covered by the Hawaiian Homes Commissions Act of 1920 arising between August 21, 1959 and June 30, 1988.

Act 14 requires the State to make twenty annual payments of \$30 million in cash or such other consideration as agreed to between the State and the Department of Hawaiian Home Lands. Interest is determined as provided in Act 14 on the unpaid balance of any funds due, but not appropriated, by the end of each respective fiscal year. The DHHL received \$30,000,000 in the current year as a transfer from the Department of Budget and Finance, State of Hawaii, to the Hawaiian Home Lands Trust Fund.

NOTE M - HAWAIIAN HOME LANDS TRUST INDIVIDUAL CLAIMS

In 1991, the Legislature enacted HRS Chapter 674 entitled "Individual Claims Resolution Under the Hawaiian Home Lands Trust" which establishes a process for individual beneficiaries of the Hawaiian Home Lands Commission Act of 1920 to file claims to recover actual economic damages they believed they suffered from a breach of trust that occurred between August 21, 1959, when Hawaii became a state and June 30, 1988. The breach must have been caused by an act or omission of an employee or officer of the State in the management and disposition of trust resources.

A Hawaiian Home Lands Trust Individual Claims Review Panel (Panel) was established under Chapter 674 to receive claims of individual beneficiaries. The Panel is required to prepare a record of each claim, including the Panel's non-binding findings and an advisory opinion concerning the probable merits of the claim. The Panel's advisory findings and advisory opinions, which are issued after adversarial hearings, must be submitted to the Legislature. The Legislature may take such action upon the claims as it deems appropriate. If the Legislature's proffered resolution is not satisfactory to a claimant, a civil action for corrective action and the recovery of actual economic damages could be initiated after October 1, 1999, but no later than December 31, 1999.

Department of Hawaiian Home Lands

State of Hawaii

Notes to the Financial Statements

June 30, 2003

NOTE M - HAWAIIAN HOME LANDS TRUST INDIVIDUAL CLAIMS (continued)

The deadline to file a claim with the Panel was August 31, 1995. A total of 4,327 claims were filed by 2,753 individuals. As of September 1999, claims from 1,376 claimants had not been reviewed by the Panel, and all but the claims of two claimants had not been acted upon by the Legislature. In 1997, the Legislature declared it to be its intent to postpone acting upon the Panel's recommendations until all claims had been reviewed and forwarded to it.

Also arising from Chapter 674, in December 1999, three claimants filed a class action lawsuit in the State Circuit Court for declaratory and injunctive relief, and for damages under HRS Chapter 673 for the Panel's and Legislature's alleged failure to remedy their breach of trust claims under HRS Chapter 674. In August 2000, the Circuit Court entered an order granting the plaintiffs' motion for summary judgment and declaratory relief as to Count I of the Complaint, and denied the State's motions on the pleadings. The plaintiff is appealing the judgment relating to the other Counts in the lawsuit with the State Supreme Court. Five other claimants filed similar individual claims actions for themselves. The plaintiffs in these other actions have stipulated to stay all proceedings in their actions pending the resolution of all questions of law in the class action lawsuit that are common to the questions of law presented in their suits. Outcome of these cases are pending.

Claims for actual damages under Chapter 674 are made against the State of Hawaii. Accordingly, counsel for the DHHL does not believe that the final settlement of the claims will have an impact on the DHHL's funds.

NOTE N - ASSESSMENTS FOR CENTRAL SERVICE AND ADMINISTRATIVE EXPENSES

The State of Hawaii has asserted that the DHHL is liable for its pro rata share of central service and administrative expenses incurred by the State in accordance with Sections 36-27 and 36-30, Hawaii Revised Statutes. Pursuant to Section 36-31, Hawaii Revised Statutes, the DHHL maintains that their funds are trust funds and are not subject to the special fund assessments. Accordingly, no provision for any liability has been made in the accompanying financial statements.

Department of Hawaiian Home Lands

State of Hawaii

Notes to the Financial Statements

June 30, 2004

NOTE N - ASSESSMENTS FOR CENTRAL SERVICE AND ADMINISTRATIVE EXPENSES (continued)

Effective July 1, 1998, Act 27, SLH 1998 amended Section 213 of the Hawaiian Homes Commissions Act and reclassified certain special funds as trust funds.

The DHHL's estimate of the asserted assessments is as follows:

<u>Year ending June 30,</u>	
1994	\$ 1,300,000
1995	2,200,000
1996	2,100,000
1997	1,900,000
1998	1,900,000
1999	679,000
2000	775,000
2001	735,000
2002	739,000
2003	1,158,000
2004	1,224,000
	<u>\$ 14,710,000</u>

NOTE O - RETIREMENT BENEFITS

Substantially all employees of the DHHL are required by Chapter 88 of the Hawaii Revised Statutes to become members of the Employees' Retirement System of the State of Hawaii (ERS), a cost sharing multiple employer public employee retirement plan. The ERS provides retirement benefits as well as death and disability benefits. Prior to June 30, 1984, the ERS consisted only of a contributory plan. In 1984, legislation was enacted to create a new noncontributory plan for members of the ERS who are also covered under Social Security. Persons employed in positions not covered by Social Security are excluded from the noncontributory plan. The noncontributory plan provides for reduced benefits and covers most eligible employees hired after June 30, 1984. Employees hired before that date were allowed to continue under the contributory plan or to elect the new noncontributory plan and receive a refund of employee contributions. All benefits vest after five and ten years of credited service under the contributory and noncontributory plans, respectively. Contributions for employees of the DHHL are paid from the State General Fund.

Actuarial valuations are prepared for the entire ERS and are not separately computed for each department or agency. Information on vested and nonvested benefits and other aspects of the ERS is also not available on a departmental or agency basis.

Department of Hawaiian Home Lands

State of Hawaii

Notes to the Financial Statements

June 30, 2004

NOTE O - RETIREMENT BENEFITS (continued)

The State's policy is to fund its required contribution annually. The DHHL's share of the retirement system expense for the year ended June 30, 2004, was included as an item to be expended by the Department of Budget and Finance and is not reflected in the DHHL's financial statements. The DHHL's special revenue funds expended approximately \$372,000 for employer contributions for the year ended June 30, 2004. The entire ERS' actuarial determination of the employer contribution requirements was met as of June 30, 2004.

The ERS issues a publicly available financial report that includes financial statements and required supplemental information. That report may be obtained from the ERS.

In addition to providing pension benefits, the State provides certain health care and life insurance benefits to all DHHL employees, their spouses and dependent children under age 19. Employees hired before July 1, 1996, who retire with at least ten years of credited service, qualify for health benefits at no cost. Employees who were hired on or after July 1, 1996, with at least ten years of credited service, qualify for health benefits on a cost-sharing basis. Employees with 25 or more years of credited service qualify for health benefits at no cost.

There are currently approximately 31,400 state retirants and beneficiaries receiving such benefits. Employees hired after July 1, 2002 will not receive health benefits for their spouse and dependents when they retire.

NOTE P - SUBSEQUENT EVENT

In September 2004, the Department entered into a transfer agreement with the State of Hawaii in connection with the transfer of approximately 1,800 acres of land consisting of four properties on three islands, to the Department. The land is partially developed and is intended to be utilized for 3,500 homes for native Hawaiians.

As part of the transfer agreement, the Department will pay \$2.2 million dollars a year for 15 years, for a total of \$33 million dollars, to reimburse the Housing and Community Development Corporation of Hawaii (HCDCH), State of Hawaii, for infrastructure costs at three of the properties. While the payment does not cover the total cost HCDCH has invested into the properties, the Department plans to develop the properties and support the State's goal of providing affordable housing. Most of the 3,500 units is expected to be considered affordable and to target native Hawaiians who are at 80 percent or below the median income level.

SUPPLEMENTAL INFORMATION

Department of Hawaiian Home Lands
State of Hawaii
Combining Balance Sheet
Nonmajor Governmental Funds
June 30, 2004

Supplemental Information

	Hawaiian Home Loan Fund	Department of Hawaiian Home Lands Revenue Bond Special Fund	Hawaiian Home Trust Fund	Native Hawaiian Rehabilitation Fund	Protocol Funds	Construction Funds	Total Other Governmental Funds
ASSETS							
Cash and short-term cash investments held in State Treasury	\$ 276,573	\$ 21,728,398	\$ 10,850,100	\$ 11,608,622	\$ 852	\$ 174,809	\$ 44,639,354
Receivables							
Loans, net of allowance for losses	4,230,300	-	-	3,997	-	-	4,234,297
Accrued interest	-	220,633	-	104,442	(24)	-	325,051
Other	14,312	-	-	-	-	-	14,312
Other assets	148,300	-	-	-	-	-	148,300
Total assets	<u>\$ 4,669,485</u>	<u>\$ 21,949,031</u>	<u>\$ 10,850,100</u>	<u>\$ 11,717,061</u>	<u>\$ 828</u>	<u>\$ 174,809</u>	<u>\$ 49,361,314</u>
LIABILITIES							
Vouchers and contracts payable	\$ -	\$ -	\$ -	\$ 78,702	\$ -	\$ 7,164	\$ 85,866
Other liabilities	18,813	-	-	-	-	-	18,813
Total liabilities	<u>18,813</u>	<u>-</u>	<u>-</u>	<u>78,702</u>	<u>-</u>	<u>7,164</u>	<u>104,679</u>
FUND BALANCES							
Reserved for:							
Encumbrances	-	-	-	1,566,830	-	174,809	1,741,639
Receivables	4,244,612	220,633	-	108,439	(24)	-	4,573,660
Guaranteed and insured loans	-	-	10,850,100	-	-	-	10,850,100
Total reserved fund balances	<u>4,244,612</u>	<u>220,633</u>	<u>10,850,100</u>	<u>1,675,269</u>	<u>(24)</u>	<u>174,809</u>	<u>17,165,399</u>
Unreserved reported in nonmajor:							
Special revenue funds	406,060	21,728,398	-	9,963,090	852	-	32,098,400
Capital projects fund	-	-	-	-	-	(7,164)	(7,164)
Total unreserved fund balances	<u>406,060</u>	<u>21,728,398</u>	<u>-</u>	<u>9,963,090</u>	<u>852</u>	<u>(7,164)</u>	<u>32,091,236</u>
Total fund balances	<u>4,650,672</u>	<u>21,949,031</u>	<u>10,850,100</u>	<u>11,638,359</u>	<u>828</u>	<u>167,645</u>	<u>49,256,635</u>
Total liabilities and fund balances	<u>\$ 4,669,485</u>	<u>\$ 21,949,031</u>	<u>\$ 10,850,100</u>	<u>\$ 11,717,061</u>	<u>\$ 828</u>	<u>\$ 174,809</u>	<u>\$ 49,361,314</u>

<div> <div>Department of Hawaiian Home Lands</div> <div>State of Hawaii</div> <div>Combining Statement of Revenues, Expenditures and Changes in Fund Balances</div> <div>Nonmajor Governmental Funds</div> <div>for the year ended June 30, 2004</div> </div>							Supplemental Information
	Hawaiian Home Loan Fund	Department of Hawaiian Home Lands Revenue Bond Special Fund	Hawaiian Home Trust Fund	Native Hawaiian Rehabilitation Fund	Protocol Funds	Construction Funds	Total Other Governmental Funds
Revenues							
Appropriations	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 600,000	\$ 600,000
Interest from short-term cash investments	-	328,041	-	296,134	45	-	\$ 624,220
Other	-	-	-	242,027	-	-	242,027
Total revenues	-	328,041	-	538,161	45	600,000	1,466,247
Expenditures							
Current:							
Administration and support services	-	2,100	-	881,531	1,692	581,372	1,466,695
Homestead services	1,026,628	-	-	9,533	-	-	1,036,161
Land management	-	-	-	5,061	-	-	5,061
Capital outlay:							
Home construction/capital projects	-	-	-	98,834	-	13,628	112,462
Debt service:							
Principal on long-term debt	-	1,155,000	-	-	-	-	1,155,000
Interest on long-term debt	-	486,820	-	-	-	-	486,820
Total expenditures	1,026,628	1,643,920	-	994,959	1,692	595,000	4,262,199
Excess (deficiency) of revenues over (under) expenditures	(1,026,628)	(1,315,879)	-	(456,798)	(1,647)	5,000	(2,795,952)
Other financing sources (uses)							
Operating transfers in	19,288	5,573,219	-	-	2,500	-	5,595,007
Operating transfers out	-	(11,000,000)	-	-	(2,130)	(133,890)	(11,136,020)
Total other financing sources (uses)	19,288	(5,426,781)	-	-	370	(133,890)	(5,541,013)
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	(1,007,340)	(6,742,660)	-	(456,798)	(1,277)	(128,890)	(8,336,965)
Lapsed appropriations	-	-	-	-	-	-	-
Net change in fund balances	(1,007,340)	(6,742,660)	-	(456,798)	(1,277)	(128,890)	(8,336,965)
Fund balances at July 1, 2003	5,658,012	28,691,691	10,850,100	12,095,157	2,105	296,535	57,593,600
Fund balances at June 30, 2004	\$ 4,650,672	\$ 21,949,031	\$ 10,850,100	\$ 11,638,359	\$ 828	\$ 167,645	\$ 49,256,635

Department of Hawaiian Home Lands
State of Hawaii

Supplemental Information

Schedule of Expenditures of Federal Awards
for the year ended June 30, 2004

Federal Grantor / Pass-through Grantor / Program or Cluster Title	Federal CFDA Number	Grant Identification Number	Federal Expenditures
<u>U.S. Department of Housing and Urban Development</u>			
Native Hawaiian Housing Block Grant, Year 1	14.873	02NHGHI0001	\$ 5,250,526
Native Hawaiian Housing Block Grant, Year 2	14.873	03NHGHI0001	79,894
Total U.S. Department of Housing and Urban Development			<u>5,330,420</u>
Total Expenditures of Federal Awards			<u><u>\$ 5,330,420</u></u>

The above schedule is prepared on the cash basis of accounting.

PART II

COMPLIANCE AND INTERNAL CONTROL

Akamine, Oyadomari & Kosaki

CERTIFIED PUBLIC ACCOUNTANTS, INC.

Independent Auditor's Report on Compliance and on Internal Control
Over Financial Reporting Based on an Audit of
Financial Statements Performed in Accordance With
Government Auditing Standards

Hawaiian Homes Commission
State of Hawaii

We have audited the financial statements of the Department of Hawaiian Home Lands, State of Hawaii, as of and for the year ended June 30, 2004, and have issued our report thereon dated October 5, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Department of Hawaiian Home Lands, State of Hawaii's, financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, including applicable provisions of the Hawaii Public Procurement Code (Chapter 103D of Hawaii Revised Statutes), and procurement rules, directives and circulars, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards. However, we noted certain immaterial instances of noncompliance which we have reported to the management of the Department of Hawaiian Home Lands, State of Hawaii, in a separate letter dated October 5, 2004.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Department of Hawaiian Home Lands, State of Hawaii's, internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted a certain matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgement, could adversely affect the Department of Hawaiian Home Lands, State of Hawaii's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. The reportable

condition is described in the accompanying schedule of findings and questioned costs as item 04-1.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that the reportable condition described above is not a material weakness. We also noted other matters involving the internal control over financial reporting that we have reported to management of the Department of Hawaiian Home Lands, State of Hawaii, in a separate letter dated October 5, 2004.

This report is intended solely for the information and use of the management of the Department of Hawaiian Home Lands, State of Hawaii, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Akamuni, Oyadomari & Kosaki CPAs, Inc.

Honolulu, Hawaii
October 5, 2004

Akamine, Oyadomari & Kosaki

CERTIFIED PUBLIC ACCOUNTANTS, INC.

Independent Auditor's Report on Compliance With Requirements
Applicable to Each Major Program and on Internal Control Over
Compliance in Accordance With OMB Circular A-133

Hawaiian Homes Commission
State of Hawaii

Compliance

We have audited the compliance of the Department of Hawaiian Home Lands, State of Hawaii, with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that are applicable to its major federal program for the year ended June 30, 2004. The Department of Hawaiian Home Lands, State of Hawaii's, major federal program is identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to its major federal program is the responsibility of the Department of Hawaiian Home Lands, State of Hawaii's, management. Our responsibility is to express an opinion on the Department of Hawaiian Home Lands, State of Hawaii's, compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Department of Hawaiian Home Lands, State of Hawaii's, compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the Department of Hawaiian Home Lands, State of Hawaii's, compliance with those requirements.

In our opinion, the Department of Hawaiian Home Lands, State of Hawaii, complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended June 30, 2004.

Internal Control Over Compliance

The management of the Department of Hawaiian Home Lands, State of Hawaii, is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the Department of Hawaiian Home Lands, State of Hawaii's, internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the management of the Department of Hawaiian Home Lands, State of Hawaii, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Akamine, Oyadomari & Kosaki CPAs, Inc.

Honolulu, Hawaii
October 5, 2004

PART III

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Department of Hawaiian Home Lands
State of Hawaii

Schedule of Findings and Questioned Costs
for the year ended June 30, 2004

Section I - Summary of Auditor's Results

Financial Statements -

Type of auditor's report issued: unqualified

Internal control over financial reporting:

- Material weakness(es) identified? _____ Yes x No
- Reportable condition(s) identified that
are not considered to be material
weakness(es)? x Yes _____ None reported

Noncompliance material to financial
statements noted? _____ Yes x No

Federal Awards -

Internal control over major programs:

- Material weakness(es) identified? _____ Yes x No
- Reportable condition(s) identified that
are not considered to be material
weakness(es)? _____ Yes x None reported

Type of auditor's report issued on compliance for major programs: unqualified

Any audit findings disclosed that are
required to be reported in accordance
with section 510(a) of Circular A-133? _____ Yes x No

Identification of major programs:

CFDA Number(s)	Name of Federal Program or Cluster
<u>14.873</u>	<u>Native Hawaiian Housing Block Grant</u>

Department of Hawaiian Home Lands
State of Hawaii

Schedule of Findings and Questioned Costs
for the year ended June 30, 2004
(continued)

Section I - Summary of Auditor's Results (continued)

Dollar threshold used to distinguish between
type A and type B programs:

\$ 300,000

Auditee qualified as low-risk auditee?

Yes

 X

No

Department of Hawaiian Home Lands

State of Hawaii

Schedule of Findings and Questioned Costs
for the year ended June 30, 2004
(continued)

Section II - Financial Statement Findings

04-1 Controls Over Accounting for Infrastructure Assets Should be Improved

Condition – The Department does not have the necessary controls to properly account for its infrastructure assets.

Criteria – Capital assets should be properly recorded and accounted for in the accounting records and financial statements.

Effect – Due to errors in the recording of certain infrastructure assets, an adjustment was necessary to eliminate \$26,163,385 of infrastructure costs and reverse \$2,772,000 of accumulated depreciation relating to these costs. This resulted in a \$23,391,985 restatement to the Department's July 31, 2003 net investment in capital assets.

Recommendation – We recommend that the Department establish controls to properly account for its infrastructure assets.

Status – We understand that the Department is in the process of establishing policies and procedures to help ensure that the Department's capital assets will be properly accounted for and recorded.

Department of Hawaiian Home Lands
State of Hawaii

Schedule of Findings and Questioned Costs
for the year ended June 30, 2004
(continued)

Section III - Federal Award Findings and Questioned Costs

None

Department of Hawaiian Home Lands
State of Hawaii

Schedule of Prior Findings and Questioned Costs
for the year ended June 30, 2004

Finding

Status

None